February 21, 2019

Polish Weekly Review

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Comment on the upcoming data and forecasts

Tomorrow, money supply reading will be released, there should not be any significant changes, we estimate M3 to have increased by 9.0% y/y. Next week starts with Statistics Poland publishing its monthly Statistical Bulletin, together with the unemployment rate for January, which we forecast at the level of 6.2% (in line with the Ministry of Family's preliminary estimate). On Thursday, final GDP for 4Q will be published, which according to the flash reading grew by 4.9% y/y. In detail, flash data and the annual print published a month ago suggested that both household consumption and investment slowed down visibly in Q4 (from 4.5 to 4.0% y/y and from 9.9 to ca. 6.8% y/y, respectively). If it wasn't for the surprisingly high contribution from net exports (1 percentage point above values implied by monthly international trade figures), growth would have cratered already in Q4. Week ends with publication of Manufacturing PMI, we do not expect any significant improvement in sentiment.

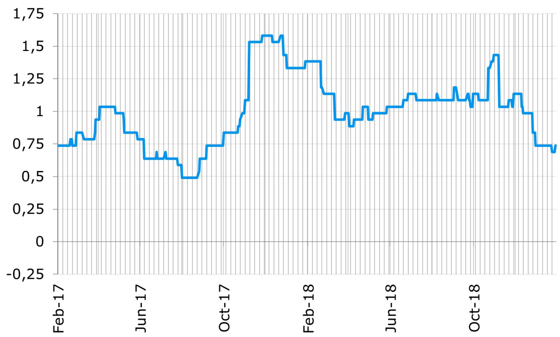
Polish data to watch: February 22nd to March 1st

Publication	Date	Period	mBank	Consensus	Prior
M3 y/y (%)	22.02	Jan	9.0	9.4	9.2
Unemployment rate (%)	25.02	Jan	6.2	6.1	5.8
GDP *final* y/y (%)	28.02	4Q	5	5	5
Manufacturing PMI (pts.)	1.03	Feb			48.2

Treasury bonds and bills auctions

Paper	Next auction	Last Offer	Yield on the prev auction (%)	Prev auction
T-bill	-	700	1.500	2/22/2017
2Y T-bond OK0720	3/8/2019	150	1.493	2/7/2019
5Y T-bond PS0424	3/8/2019	1500	2.158	2/7/2019
10Y T-bond DS1029	3/8/2019	1500	2.813	2/7/2019
30Y T-bond WS0447	3/8/2019	30	3.149	1/25/2019
5Y floater WZ0524	3/8/2019	600	-	2/7/2019
10Y floater WZ0528	3/8/2019	1000	-	2/7/2019

Reality vs analysts' expectations (surprise index* for Poland)



Comment

CPI data for January moved the surprise index one point downward, but yesterday's industrial production data were higher then expected, and the surprise index came back to its previous level. This week there are 3 readings that can move the index: M3 money supply, unemployment rate in January and detailed GDP data for Q4.

* Surprise index presents in a synthetic way how the market was surprised by macroeconomic releases (it is constructed on daily basis as weighted average of differences between selected releases and Bloomberg forecast consensus).

Our view in a nutshell

Fundamentals

- In 2019, Poland will no longer be able to escape economic gravity. With worse consumption prospects and public investment peaking in annual terms in 2019, we expect GDP to grow by 3.7% y/y this year. Q1 is set to marked by a major drop in y/y growth and the stable path in the latter quarters is dependent on a rebound in the global economy.
- Core inflation is projected to rise steadily, but CPI inflation is likely to stay low and undershoot the MPC target in 2019. Electricity prices were frozen, but there are many other administered prices that will rise this year. Second round effects after surge in electricity costs on the firms' side will be marginal, though. With low food and fuel prices, the beginning of the year will be marked by low inflation. The uptrend later depends on core inflation accelerating.
- The MPC is now talking about holding rates steady until 2021 (the end of most members' term) and – given the overall environment (both global and local factors) – we concur. We don't expect any rate changes in Poland in the foreseeable future. Risks to this forecast are balanced.
- General government deficit was likely the lowest in history in 2018. The name of the game now is fiscal stimulaion and we expect fiscal space to be used to cushion the slowdown.

Financial markets

- Political issues moved into the background and the markets are clearly unconcerned with local risks. The impact of PLN-specific factors (other than loose monetary policy) on the currency has been relatively small.
- The PLN proved to be exceptionally resilient in recent months: neither the increase in global rates, nor their subsequent decline and violent repricing of monetary policy expectations managed to break it out of the narrow, 2.5% range vis-a-vis the euro.
- While this might be seen as a good omen, the room for PLN to strengthen is not really there: cyclicality, low nominal interest rates, attractiveness of PLN asset markets and worsening terms of trade suggest that PLN strengthening would not be welcome by local stakeholders, big and small. As a result, we expect EURPLN to remain essentially flat within the forecast horizon. Risks are tilted to the upside as market participants are drawing smooth GDP path and underestimate the onset of the slowdown.

mBank forecasts

	2015	2016	2017	2018	2019 F	2020 F
GDP y/y (%)	3.8	3.0	4.8	5.1	3.7	3.3
CPI Inflation y/y (average %)	-0.9	-0.6	2.0	1.6	1.9	2.5
General government balance (%GDP)	-2.7	-2.2	-1.4	-0.2	-0.7	-1.1
Current account (%GDP)	-0.6	-0.5	0.2	-0.6	-1.2	-1.4
Unemployment rate (end of period %)	9.8	8.2	6.6	5.9	5.4	4.9
Repo rate (end of period %)	1.5	1.5	1.5	1.5	1.5	1.5

	2018 Q1	2018 Q2	2018 Q3	2018 Q4 F	2019 Q1 F	2019 Q2 F	2019 Q3 F	2019 Q4 F
GDP y/y (%)	5.3	5.1	5.1	4.8	3.8	3.7	3.5	3.6
Individual consumption y/y (%)	4.7	4.9	4.5	4.0	3.7	3.5	3.4	3.3
Public Consumption y/y (%)	3.0	3.5	3.6	4.4	4.0	4.0	4.0	4.0
Investment y/y (%)	8.2	4.7	9.9	6.9	5.0	5.0	4.0	4.0
Inflation rate (% average)	1.5	1.7	1.9	1.4	1.5	1.8	1.9	2.2
Unemployment rate (% eop)	6.6	5.9	5.7	5.9	6.0	5.4	5.2	5.4
NBP repo rate (% eop)	1.50	1.50	1.50	1.50	1.50	1.50	1.50	1.50
Wibor 3M (% eop)	1.70	1.70	1.72	1.72	1.72	1.72	1.72	1.73
2Y Polish bond yields (% eop)	1.49	1.63	1.56	1.35	1.40	1.42	1.44	1.46
10Y Polish bond yields (% eop)	3.18	3.22	3.24	2.83	2.80	2.83	2.87	2.91
EUR/PLN (eop)	4.21	4.37	4.28	4.29	4.35	4.30	4.25	4.25
USD/PLN (eop)	3.42	3.74	3.69	3.74	3.85	3.77	3.70	3.66

F - forecast

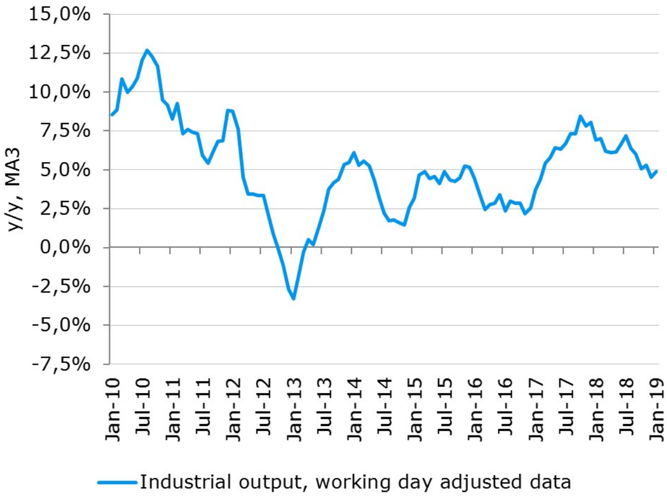
Economics

The slowdown is upon us, despite the strong January industrial output

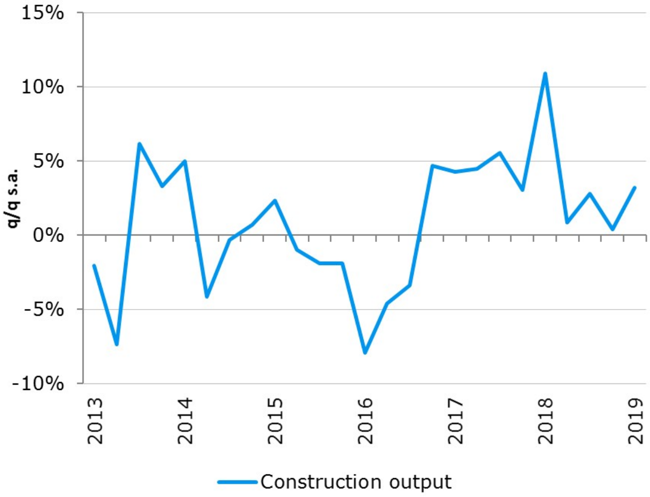
Real sphere data for January generally surprised to the upside. To some extent, this likely the mirror image of the weak December, not a change in trend. The latter is still a downward one, as seen in filtered industrial and retail data. In addition, construction output was the sole exception (large negative surprise) and the behavior of this sector is one of the key factors influencing our below-consensus call regarding Q1 GDP. To sum up – we believe that GDP is likely to decelerate harder and less smoothly than most forecasters do. For Q1, we see sub-4% growth already and January figures do not contradict that.

As usual, below are our detailed comments on last week's releases

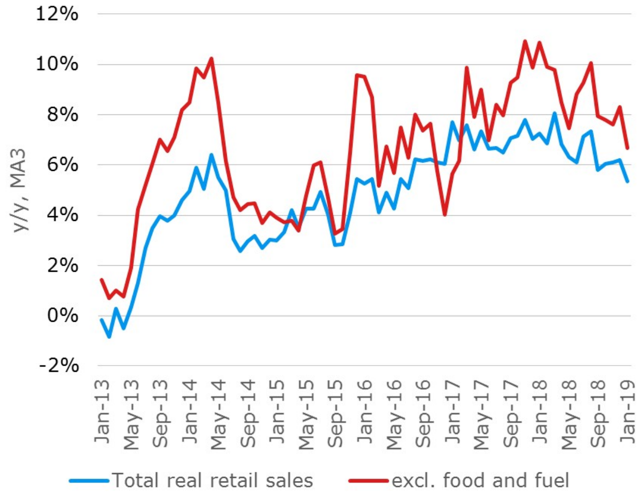
In January industrial output rose by 6.1% y/y, smashing expectations (consensus ca. 4% y/y, our forecast at 3.1% y/y). Production accelerated despite the stable arrangement of working days (0 y/y, just as a month ago) and negative signals sent by multiple indicators, from soft and hard European data, through industrial sentiment indicators from Markit and Statistics Poland. On a monthly basis, industry rose by 1.7% m/m, which is the best result since May last year. The downtrend in IP growth is intact, but output definitely did not take a leg down in January. A quick review of the details of the release reveals no one-offs – the acceleration was broad-based multiple branches of industry contributed positively. In particular, the usual list of slowest growing industries does not contain any export-oriented ones. Domestic-oriented industries (apart from those tied to construction), such as chemicals and food & beverages production are also looking very good.



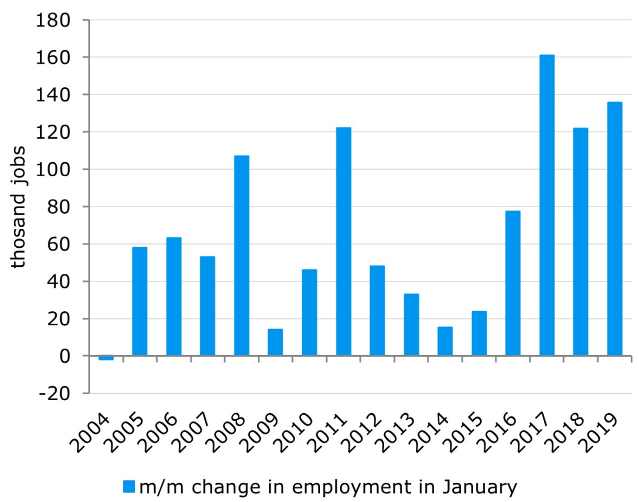
Construction output rose by 3.2% y/y, significantly below market consensus (ca. 8% y/y), but slightly above our forecast of 2% y/y. The key factor behind the slowdown is the massive (more than 8 p.p.) statistical base from the previous January – recall that Q1 2018 was this investment cycle's strongest quarter. January itself was a quite strong month, with output growing by 3.2% m/m on a seasonally adjusted basis. Given the unfavorable weather conditions prevailing throughout most of the month, this is especially impressive. However, the entire year is set to bring weaker construction data. Based on EU fund flows and contracts, local government investment plans and progress in road and railway tenders, we judge that public investment will rise only slightly this year (compared to ca. 30% y/y in 2018). It will be reflected in slower construction output growth.

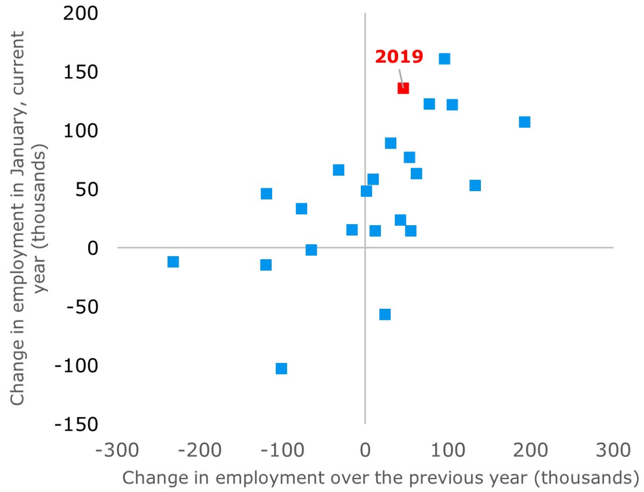


Retail sales rose by 5.2% y/y in constant prices, matching market consensus, but beating our forecast (4.4% y/y). From our point of view, there was only one source of the surprise – food sales rebounded much more strongly after the weak December (from -1.4 to 6.1% y/y). Other categories evolved more or less in line with fundamentals and our forecast: (1) fuel sales slowed down less than anticipated due to higher real sales; (2) sales of durable and semi-durable goods accelerated only modestly, by 2 p.p. at maximum; (3) sales in other non-specialized stores failed to accelerate after the weak December, perhaps due to a smaller number of trading Sundays; (4) the Other category (mostly building materials) decelerated hard, from 10.9 to 4.9% y/y – we are likely seeing the lagged effect of lower housing sales in 2018. Thus, we estimate that core retail sales slowed down visibly (real retail sales excl. food and fuel down from 6.5 to 5.0% y/y) and the downtrend in retail sales figures is still intact (see the graph below).

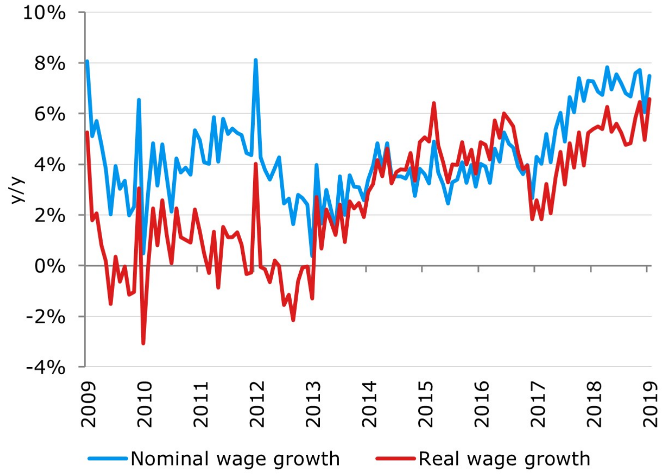


In January corporate employment rose by 2.9% y/y (prev. 2.8% y/y, market consensus and our forecast 2.0% y/y). While this print is an upside surprise, one has to remember that annual resampling (due to corporates that gained or lost employees in the previous year and either entered or quit the 9+ sample) remains the key factor influencing the m/m change in employment at the turn of the year. As such January m/m employment growth is more of a reflection of last year's development than this year's labor market strength. In any case, the 136 thousand increase in the number of employees recorded this January, albeit relatively high, is consistent with last year's overall employment growth (see the graph below). To assess whether employment growth actually slowed or accelerated this year, subsequent monthly prints will have to be observe. Currently, the prospects are mixed at best. On one hand, a broad set of soft and hard indicators points to weakening / slowing labor demand. The more so since the macroeconomic environment is projected to become more challenging this year due to the expected slowdown in GDP growth. In addition, the inflow of foreign workers has clearly ground to a halt in Q4, exacerbating labor shortages and restricting potential supply. On the other hand, recent NBP enterprise survey points to a record-high employment growth expected by enterprises, contradicting other soft indicators (PMI and Statistics Poland own sentiment surveys). Weighing all the available evidence, we are leaning towards the softer side and expecting weaker employment growth this year.





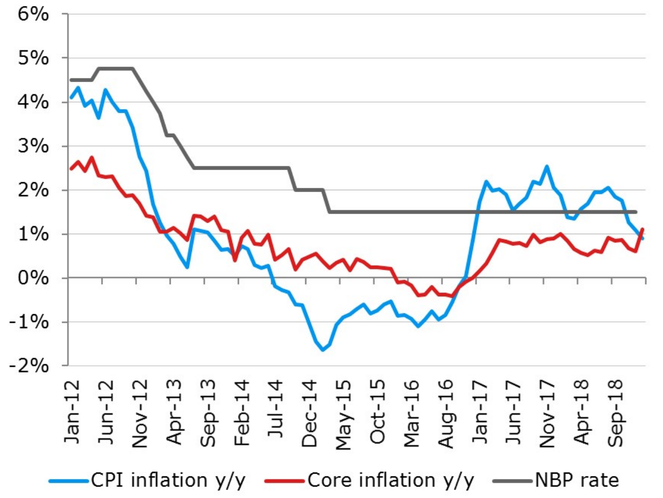
Average gross wage rose by 7.5% y/y, beating estimates and our forecast (6.8-6.9 and 7.1% y/y, respectively). Here sampling issues are of little consequence. In our view, the acceleration vis-a-vis the weak December print (6.1% y/y) can be attributed to low base effects in manufacturing wages, while the surprise itself is a result of higher mining bonuses or stronger-than-anticipated wage hikes in certain service sectors. The details of the release will be published in the Statistical Bulletin next week. In any case, the trend in nominal wage growth has remained flat (ca. 7% y/y) for 1.5 years. Of note is the fact that due to low January CPI print, real wage growth surged to a new cycle high (6.6% y/y).



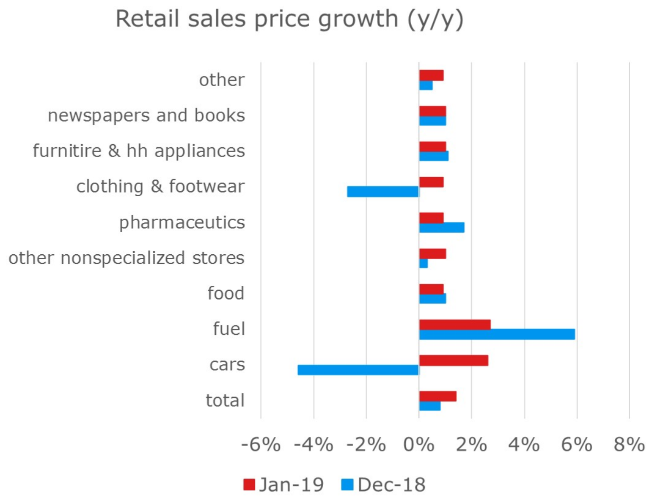
Puzzling over the latest CPI data

According to the preliminary reading, inflation declined from 1.1 to 0.9% y/y in January, a tad below market consensus and our forecast of 1.0% y/y. However, due to high uncertainty related to the behavior of administered prices and the reaction of stickier corporate prices to last year's run-up in labor and commodity costs, the margin of error has always been high. Today's reading is dispelling some of the questions. Final data will be published in mid-March, along with the revised CPI basket.

What do we know, then? Prices of food, tobacco products, non-alcoholic and alcoholic beverages rose by 0.9% m/m, implying a somewhat stronger than anticipated rise in food prices. Prices in the Transport category declined by 1.9% m/m. Assuming that our forecast of liquid fuels was correct, this suggests that prices of vehicles and transport services declined only marginally, as opposed to our forecast (-0.5 vs. -2.6%). The largest and most interesting piece of the puzzle is the Housing category. Overall, prices declined by 0.7% m/m there. Given the Statistical Office's explanation regarding energy freeze scheme, we believe that the CSO recorded a sizable decline in electricity prices on a monthly basis. Thus, we are back to our early assumption that the various parts of the energy freeze scheme would be introduced in different months, resulting in lower prices in January (due to excise tax and fee cuts, effective immediately) and an increase in electricity tariffs in February and March. At the end of the day, the overall electricity prices should remain unchanged vis-a-vis 2018. Moreover, if our assumptions are plugged in, this implies a very modest increase in other parts of housing goods and services (such as rents).



CPI release lacks many details, but the only way to square the known details with the headline is to assume increases in other core categories – at this point we can only speculate which ones, but second-round effects of higher labor costs are a tempting possibility. This means that core inflation likely surged in January from 0.6 to 1.0-1.1% y/y, significantly above consensus, but close to our forecast. While the key details from CPI release are missing, retail sales deflators offer a tantalizing possibility. In January retail sales prices jumped from 0.8 to 1.4% y/y, driven by core categories – prices excluding fuel and food swung from -0.6 to 1.3% y/y. What happened, then? Detailed sales data indicate that the move was driven by cars (from -4.6 to 2.6% y/y) and clothing & footwear (from -2.6 to 0.9% y/y). Granted, CPI basket and retail sales are weighed differently, but this offers a strong indication that core goods were the primary driver of higher core inflation.



Summarizing, negative surprise is hiding quite encouraging details: not only the significant increase in core inflation in February, but also the probable correction of energy prices in February or March (depends on the energy regulator's decision, still pending). Those aspects, together with high base effects from the previous year should result in sharp acceleration of inflation in the following months. We estimate it to grow to even 1.8-1.9% in February and March. There remains a question of the structure and scale of core inflation growth, which will be answered with March data reading (publication together with new CPI basket). It does not change anything for the MPC – inflation forecasts (also those of the NBP staff) are still below the target.

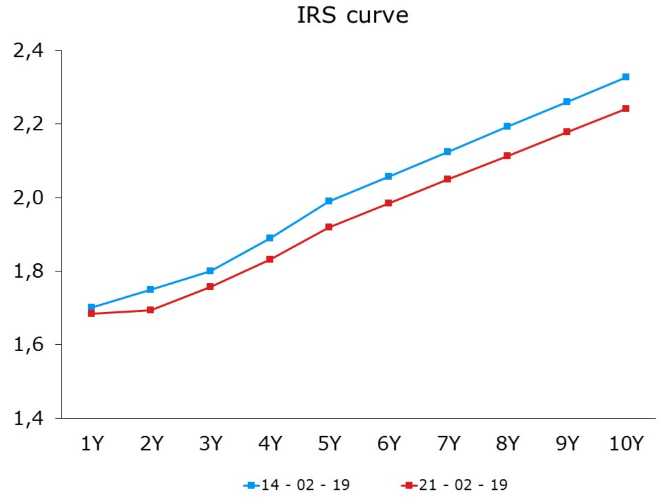
Fixed income

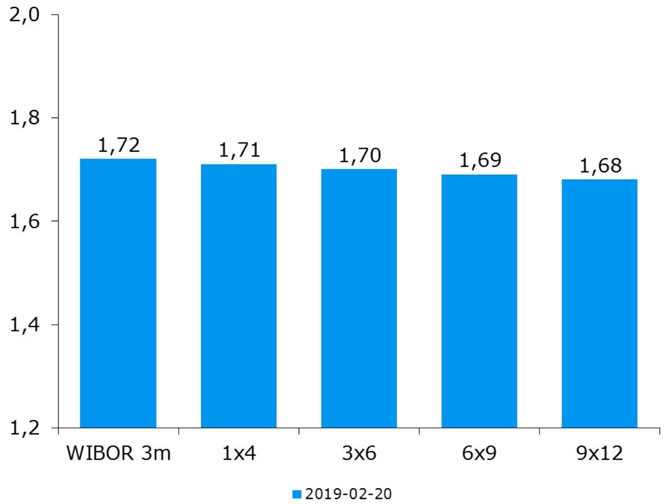
Check out our low, low rates

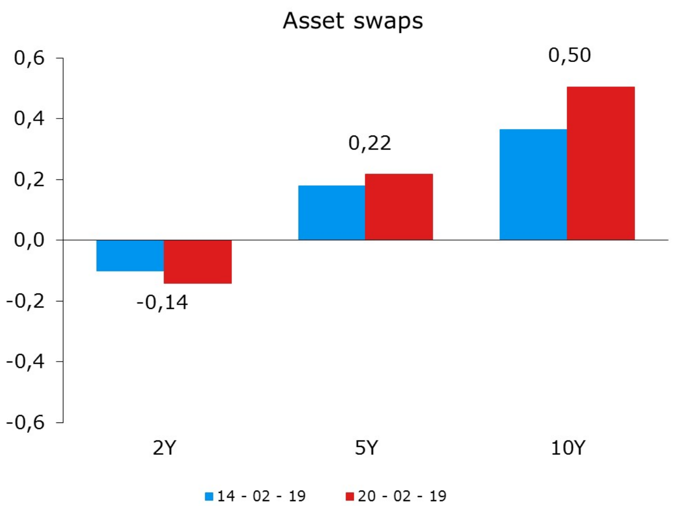
Poland has financed 52% of 2019 borrowing needs after February. Today's switching auction was huge, and the ministry sold PLN 10b with good demand. Yields on WS0428 touched 2.63%, but IRS rates are even lower – the consequence are wide ASW spreads. Given the shape of the curve, PS0424/5y is especially high (currently 20 bps).

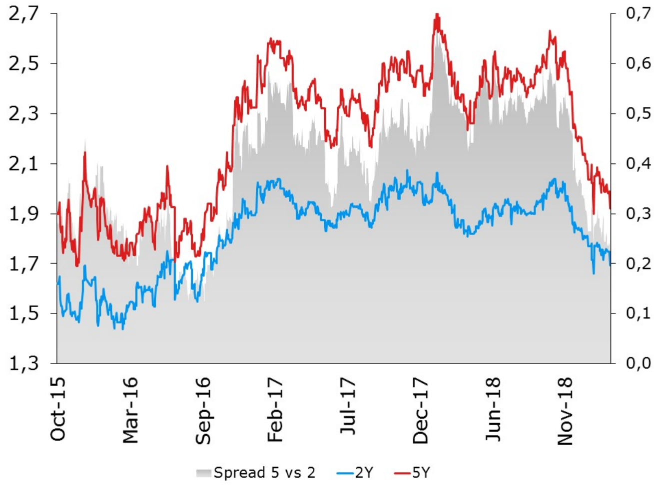
DS1023/5y is 6 bps, WS0428/10y is 36 bps. PS0424/WS0428 is 51 bps. WS0428/Bund is 251 bps.

DS1020 is trading at 1.46% (3 bps up), DS1023 is trading at 2.02% (5 bps down) and WS0428 is trading at 2.65% (5 bps down).









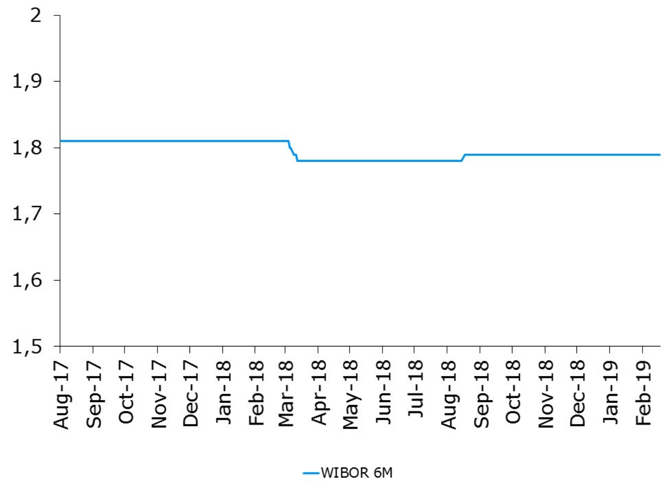
Money market

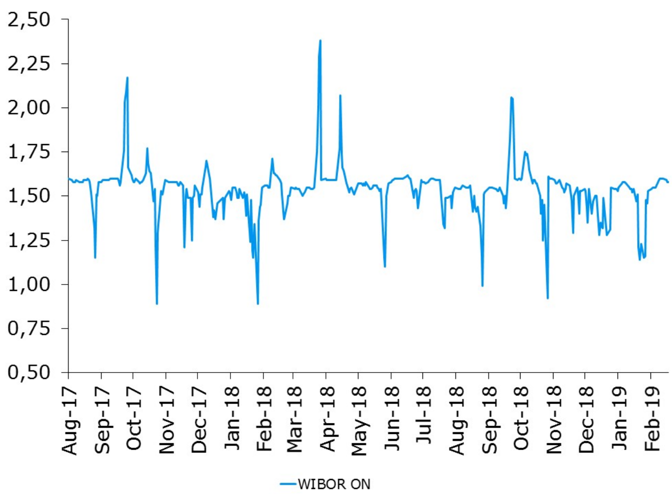
No volatility and no story

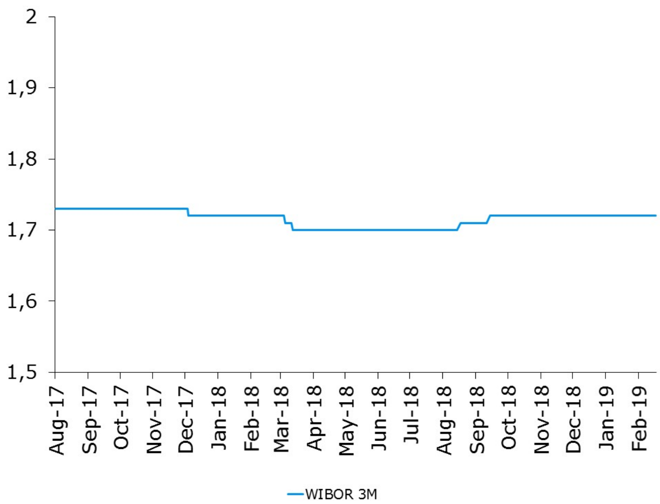
Lack of both volatility and a story on Polish yields persists. Market is mainly flow-driven, plus, we are following core markets. CPI print came at 0.9%, slightly below market consensus at 1.0%. There are indications that this is the bottom (see the comment in the Economics section).

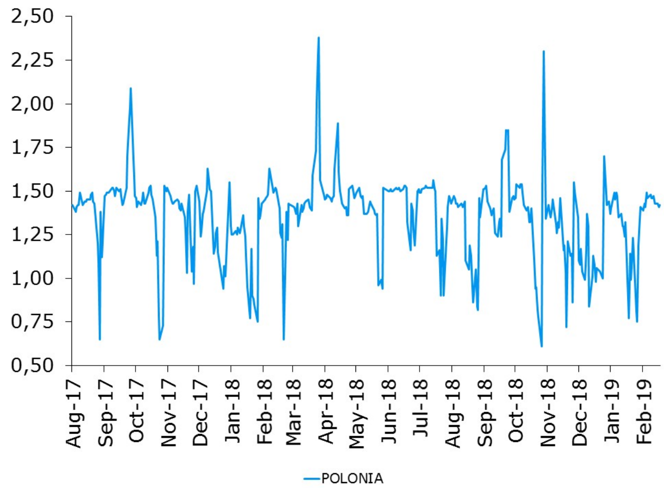
Cash rates remained stable around 1.48%. We are going into month end, which will insert some volatility to the overnight rate market.

Ref rate vs Polonia averages:
30 day 17 bp
90 day 23 bp









Forex

Spot: EUR/PLN testing 4.34 resistance. The sleepy, directionless market continues. EUR/PLN had a push to 4.3450, but it failed at first attempt. 4.3290 – 4.3455 constitutes the range from Thursday to Thursday. The excellent local market data: industrial output, wage and retail sales data seemed to be ignored. Given the NBP stance, rate differentials are set to deteriorate, which is likely to result in Zloty depreciating gradually. Additionally, the prolonged trade tensions between the United States and its trading partners, as well as the Brexit uncertainty, will keep all EM currencies exposed to further weakness. Nevertheless, we believe that the new range EUR/PLN will constitute in 4.30-4.35 window. We are aiming to play that range, preferable from the long PLN side.

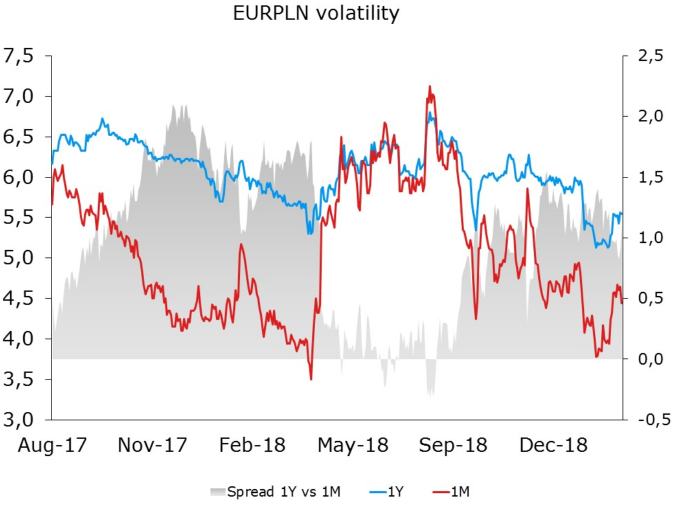
Opts: EUR/PLN vols – touch lower. The tight range in EUR/PLN says it all! Both realized volatility metrics (daily and high frequency) are still on the move down. The daily observation is especially depressed and close to this year low. As a consequence, implied volatility keeps on melting. 1 month EUR/PLN ATM mid is 4.4% (0.2% lower) this Thursday, 3 month mid is 4.7% (0.2% lower), 1 year is 5.4% (0.2% lower). The skew and the currency spread (difference between USD/PLN vol and EUR/PLN vol) are roughly unchanged.

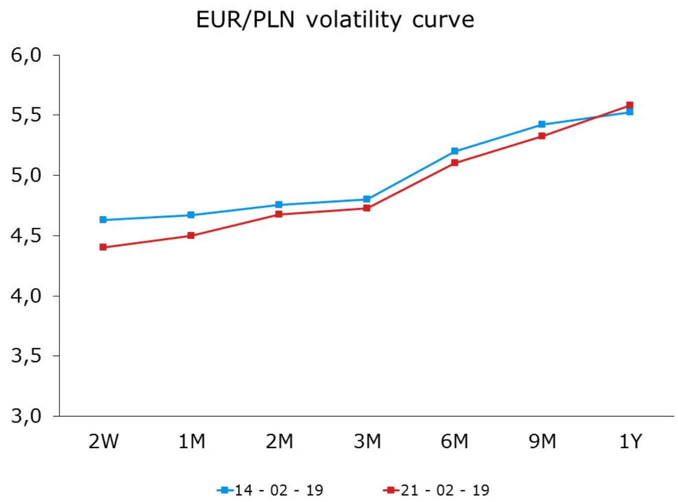
Short-term forecasts

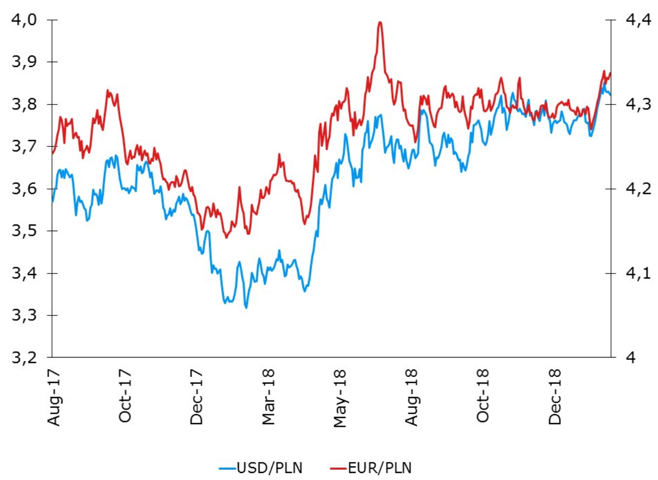
Main supports / resistances:
EUR/PLN: 4.2600 / 4.3500
USD/PLN: 3.6000 / 3.9000

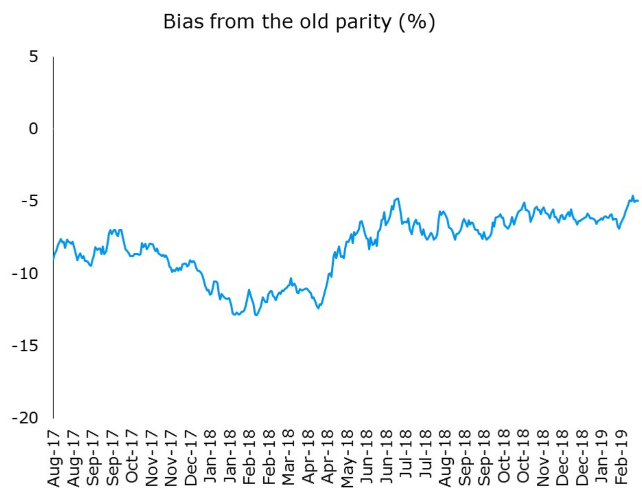
Spot: Current position: Short EUR/PLN

We are still short EUR/PLN at 4.34 with a room to add at 4.35, and the stop at 4.37 with hopes to see levels below 4.30.









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Market prices update

Money market rates (mid close)								FRA rates (mid close)				
Date	FXSW 3M	WIBOR 3M	FXSW 6M	WIBOR 6M	FXSW 1Y	WIBOR 1Y	1x4	3x6	6x9	9x12	12x15	6x12
2/14/2019	1.79	1.72	1.86	1.69	2.00	1.77	1.71	1.71	1.70	1.70	1.69	1.76
2/17/2019	1.70	1.72	1.78	1.69	1.92	1.77	1.71	1.71	1.70	1.70	1.69	1.76
2/18/2019	1.68	1.72	1.84	1.69	1.99	1.77	1.72	1.71	1.70	1.70	1.70	1.76
2/19/2019	1.56	1.72	1.67	1.69	1.81	1.77	1.72	1.71	1.70	1.70	1.69	1.76
2/20/2019	1.63	1.72	1.74	1.69	1.89	1.77	1.71	1.70	1.69	1.68	1.67	1.74

Last primary market rates							
Paper	Au. date	Maturity	Avg. price	Avg. yield	Supply	Demand	Sold
32W TB	2/22/2017	8/30/2017	99.21	1.50	700	1832	726
OK0521	2/7/2019	5/25/2021	96.67	1.49	150	450	180
PS0424	2/7/2019	4/25/2024	101.65	2.16	1500	3445	1570
DS1029	2/7/2019	10/25/2029	99.40	2.81	1500	1066	1666

Fixed income market rates (closing mid-market levels)								
Date	1Y WIBOR	1Y T-bill	2Y IRS	OK0720	5Y IRS	PS0423	10Y IRS	WS0428
2/14/2019	1.770	1.421	1.750	1.649	1.990	2.169	2.328	2.693
2/17/2019	1.770	1.429	1.747	1.658	1.982	2.175	2.315	2.687
2/18/2019	1.770	1.438	1.747	1.556	1.990	2.176	2.322	2.683
2/19/2019	1.770	1.420	1.740	1.653	1.975	2.152	2.300	2.664
2/20/2019	1.770	1.420	1.693	1.551	1.920	2.137	2.242	2.747

EUR/PLN 0-delta stradle					25-delta RR		25-delta FLY
Date	1M	3M	6M	1Y	1M	1Y	1Y
2/14/2019	4.67	4.80	5.20	5.53	5.53	1.49	0.49
2/17/2019	4.60	4.73	5.05	5.43	5.43	1.49	0.49
2/18/2019	4.64	4.85	5.17	5.56	5.56	1.49	0.50
2/19/2019	4.44	4.78	5.08	5.55	5.55	1.49	0.49
2/20/2019	4.50	4.73	5.11	5.58	5.58	1.50	0.50

PLN Spot performance						
Date	EURPLN	USDPLN	CHFPLN	JPYPLN	HUFPLN	CZKPLN
2/14/2019	4.3394	3.8516	3.8182	3.4700	1.3610	0.1683
2/17/2019	4.3243	3.8326	3.8081	3.4712	1.3596	0.1682
2/18/2019	4.3317	3.8286	3.8150	3.4627	1.3621	0.1685
2/19/2019	4.3303	3.8311	3.8141	3.4582	1.3611	0.1682
2/20/2019	4.3371	3.8221	3.8190	3.4501	1.3661	0.1688

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